



Issue Brief: TAXATION OF REMOTE SALES

Updated January 2007

Background

To date, Congress and the Supreme Court have prevented state and local governments from collecting taxes on goods not purchased in a physical store but through remote means, for example the Internet, catalog, telephone, or other non-physical media. In *National Bellas Hess v. Illinois* (1967) and again in *Quill v. North Dakota* (1992), the U.S. Supreme Court ruled that states cannot require vendors to collect and remit taxes on purchases made in states in which the vendors do not have a physical presence, or nexus. The basis for these decisions is that requiring businesses to collect taxes on such purchases would impose an undue burden because of the complexity of and variations in state and local government sales tax rates and structures.

Although these Court decisions were based on catalog sales and were handed down before the emergence of the Internet and e-commerce, the rulings extend to all remote sales—including those made over the Internet. Over the past few years, Congress has attempted to act in order to overcome the effects of the *Bellas Hess* and *Quill* decisions and allow state and local governments to require retailers to collect and remit taxes on remote sales.

William Fox of the University of Tennessee noted in a 2004 study for the National Governors Association that without the ability to collect sales taxes on Internet purchases, state and local governments could lose \$21-33 billion per year in tax revenues by 2008. The study also noted that multichannel retailing (retailers with both physical and Internet stores) saw a 60% increase in Internet sales in 2002, and as broadband enters more homes in the years ahead, online sales are expected to grow at 20% over the next 5 years. The U.S. Department of Commerce reports that in 2005 Internet sales rose 24% over 2004 sales levels, and there is no doubt that this trend will continue as more citizens incorporate Web use into their daily activities.

The Streamlined Sales Tax Project

To overcome the sticking point in the *Bellas Hess* and *Quill* decisions—the compliance burden on vendors—a group of public and private entities formed the Streamlined Sales Tax Project (SSTP), in March 2000 with the goal of simplifying state and local tax systems. More than 40 states joined the SSTP, along with state and local government associations, retailers, and retail associations. The participants developed a set of recommendations for the terms of an *Agreement* that would simplify the multiple tax systems across the country and create equity in business practices between “bricks and mortar” and “remote” vendors.

The first step in moving the *Agreement* forward was to establish a group of implementing states, the Streamlined Sales Tax Implementing States (SSTIS). On November 12, 2002, the SSTIS officially approved the provisions of the *Agreement* outlining a uniform system for the administration and collection of all sales taxes – whether collected at a physical location or remotely.

The Streamlined Sales and Use Tax Agreement includes the following provisions:

- Centralized state administration of sales tax collection and the distribution thereof to local jurisdictions
- An electronic registration system for all vendors
- State and local governments limited to a single general sales tax rate
- State creation and upkeep of a database of tax rate information for all taxing jurisdictions
- Uniform sourcing for all taxable transactions
- Protection of the states' right to exempt any item or service from taxation (e.g., food)

- Uniform definition of goods (e.g., if a state taxes “candy,” it must adopt the *Agreement’s* definition of “candy”)
- Standardization of tax holidays

A Governing Board comprised of representatives of each member state – states that have adopted the *Agreement* - was established to interpret and amend the *Agreement*, and resolve issues such as binding dates, provisions for state participation and non-participation, appointment of advisory boards, and to certify the automated systems and service providers. Non-member states may have representatives serve as ex-officio members to the Board, providing important input on various aspects of the *Agreement*.

On October 1, 2005 the *Agreement* went into effect for states that have adopted it through legislation. Retailers in those states, on a voluntary basis, may use the system to collect and remit sales and use taxes to those states. There are currently fifteen full member states that are collecting remote sales tax revenues: **Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont and West Virginia**. Six states are associate member states (those states that have adopted most of the *Agreement* but have until January 1, 2008 to be in full compliance - **Arkansas, Nevada, Ohio, Tennessee, Utah and Wyoming**. Two other states, **Washington and Hawaii**, are expected to become member states some time in 2007.

Also as of October 1, 2005, the State and Local Government Advisory Group (SLAC) began its work to advise the Governing Board on various technical issues that remain outstanding. For the first time, local governments have official recognition by the Governing Board. There are twelve local government representatives to the SLAC, three from each of the local government national associations – GFOA, the National League of Cities (NLC), the National Association of Counties (NACo), and the US Conference of Mayors (USCM). The GFOA representatives are David Vehaun, Chair of the GFOA’s Governmental Budgeting and Fiscal Policy Committee and Management Services Administrator, Rock Hill, SC; Michael Bailey, Chair of the GFOA’s Technology Resource Group and Finance and Information Services Administrator for the City of Renton, WA; and Eric Johnson, former GFOA Executive Board member and Director of Management and Budget, Hillsborough County, FL. Mike Bailey also serves as the local government representative to the Governing Board as an ex-officio member, and is a member of SLAC’s Steering Committee.

Federal Legislation

In the 109th Congress, legislation was introduced supporting the *Streamlined Sales and Use Tax Agreement* by Senators Dorgan (D-ND) and Enzi (R-WY). While GFOA and local government associations support federal legislation allowing states and localities to collect taxes on remote sales, both bills included provisions harmful to local governments. For example, both call for state and local governments to simplify their telecommunication taxes in order to collect taxes on remote sales. GFOA, NLC, and USCM have all expressed concern that the legislation could open the door for the telecommunications industry to push for an all-out ban on the ability of local governments to impose fees on a range of telecommunication services, including rights-of-way fees, per-line subscriber charges, and franchise fees. Revenues from these fees are a major source of funding for local governments. Local government associations continue to call for communications reform proposals to be separate from remote sales and use tax legislation.

GFOA, NLC, USCM, and other associations will continue to work with Senators Enzi and Dorgan to reach a compromise on this issue. GFOA members are encouraged to write their congressmen and senators and ask that the telecommunications provisions be eliminated from streamlined sales tax legislation, especially when the legislation is reintroduced in the 110th Congress.

Local Governments' Interest in the Agreement

While the SSTP and the *Agreement* address state laws and taxation policy, there are specific issues of interest to local governments that the GFOA is monitoring. These include:

- The *Agreement* changes the fundamental taxation mechanism from origin-based sourcing to destination-based sourcing. Destination-based sourcing establishes the taxing jurisdiction for transactions as the jurisdiction where the good or service is received. This differs from origin-based sourcing, where a transaction is taxed where the good or service is purchased.
- A single state administrative entity will be responsible for administering each state's sales and use taxes implemented under this system. This agency will then be responsible for remitting to local jurisdictions the correct amount of sales and use revenue due them. Some local authorities have expressed concern regarding remittance procedures to local governments.
- Many states currently provide sellers with ongoing, minimal compensation for collecting sales and use taxes on behalf of the states. This is what is known as "vendor compensation." The proposed federal legislation requires *every* member state in the *Agreement* to provide "reasonable compensation" to sellers for costs incurred in the collection and remittance of sales and use taxes.

This requirement exceeds provisions in the *Agreement* which limits compensation to sellers for the upfront costs incurred in establishing collection and administrative procedures under the *Agreement*. The *Agreement* does not address any ongoing compensation mechanism. The *Agreement* also establishes that a study will be undertaken to examine the ultimate cost of collection incurred by sellers under the *Agreement*. That study is currently underway and should be completed in 2006.

State and local government organizations have identified issues of concern with the "reasonable compensation" provision in the federal legislation. These include the uncapped and premature nature of the requirement; fiscal impact of providing compensation; streamlining the various legislative approaches taken by states in the *Agreement*; and the political difficulty of placing limitations on additional compensation to remote vendors.

Looking Ahead in 2007

The GFOA will be working closely with our colleagues at the local and state levels to ensure that the ability to collect and remit taxes on remote sales will be formulated and implemented in an equitable manner that does not diminish the taxation authority of local jurisdictions.

Related Public Policy Statements (see www.GFOA.org)

- Taxation of Interstate Mail-Order Sales (1986)
- State and Local Government Authority Over Telecommunications (1995)
- Federal Preemption of State and Local Government Taxing Authority (1997)

Additional Resources

- Streamlined Sales Tax Project: www.streamlinedsalestax.org